BUSINESS INCOME TAX RETURNS

This section describes the federal and state income tax returns that must be filed by various business entities. The business also may be liable for estimated tax payments, sales and use tax, and other taxes which are discussed later in this chapter.

SOLE PROPRIETORSHIP

For federal tax purposes, the sole proprietor reports income and expenses from the business on Schedule C or Schedule C-EZ (Form 1040) and any related forms and schedules. The net income or loss from the business is then transferred to the proprietor's individual Form 1040. The sole proprietor uses Schedule SE (Form 1040) to report net self-employment income for purposes of computing the Social Security and Medicare self-employment tax.

There is no separate form for reporting sole proprietorship income on the Minnesota tax return. To compute Minnesota income tax, the proprietor uses Form M1, the individual income tax return form. A copy of the federal Form 1040, including a copy of Schedule C or Schedule C-EZ and other supporting schedules, must be attached to the Minnesota return.

PARTNERSHIP

For federal tax purposes, the partnership files Form 1065, which is an information return. No tax is paid by the partnership with this return. Other forms and schedules may be required, including Schedules K and K-1. Individual partners use Schedule E (Form 1040), which is prepared using information from their Schedule K-1 of Form 1065, to report their distributive share of partnership income, deductions, credits and losses on the individual Form 1040. Schedule SE (Form 1040) is used to compute Social Security and Medicare self-employment tax.

A married couple who jointly operate an unincorporated business and who file a joint federal income tax return can elect not to be treated as a partnership for federal tax purposes provided that the husband and wife are the only members of the joint venture and that both husband and wife materially participate in the running of the business. For more information, see www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Husband-and-Wife-Business.

For state tax purposes, the partnership completes Form M3, Partnership Return and files it with the Department of Revenue along with a copy of federal Form 1065 and Schedules K and K-1. The partnership may also have to pay a minimum fee based on property, payroll, and sales attributable to Minnesota. If the partnership has items of income, credits or modifications that are different from its federal return, the partnership should also issue and file Schedule KPI and/or Schedule KPC. If the partnership has nonresident individual partners it may file a composite income tax on their behalf using Schedule KC. If it has nonresident individual partners who will not be included in such composite income tax, generally the partnership is required to withhold income tax on behalf of such partners and remit it with its Minnesota partnership return, by using Schedule MW-3NR. Individual partners who are not included on the composite income tax also complete Form M1, the individual income tax return.

C CORPORATION

For federal tax purposes, the C corporation reports its income, deductions and credits, and computes its tax on Form 1120 or Form 1120-A. Supporting forms and schedules may be required. If the corporation issues dividends, it must annually send its shareholders Form 1099DIV, stating the amount of dividends paid. A copy of Form 1099-DIV also is filed with the Internal Revenue Service. Shareholders report dividends received from the corporation on their individual Form 1040.

The C corporation determines its state tax on Form M4, Corporation Franchise Tax return. The corporation also may have to pay a minimum fee based on property, payroll, and sales attributable to Minnesota.

S CORPORATION

For federal tax purposes, the S corporation generally is not separately taxed. The S corporation files Form 1120S and supporting forms and schedules, including Schedules K and K-1 (Form 1120S). Individual shareholders report their share of the S corporation's income, deductions, and credits on their individual Form 1040, using information contained on the Schedule K-1.

S corporations file Minnesota Form M8 Corporation Return, with the state, along with copies of federal Form 1120S and supporting forms and schedules. In addition, the S corporation may have to pay a minimum fee based on property, payroll, and sales attributable to Minnesota. If the S corporation has items of income, credits or modifications that are different from the federal return it should also issue and file Schedule KS. If the S corporation has nonresident individual shareholders it may file a composite income tax on their behalf using Schedule KC. If it has nonresident individual shareholders who will not be included on such a Schedule, generally the S corporation is required to withhold income tax on behalf of such shareholders and remit it with the Minnesota S corporation return by using Schedule MW-3NR. Individual shareholders who are not included on the Schedule KC must also complete Form M1, the individual income tax return.

LIMITED LIABILITY COMPANY

Under Treasury Regulations the organizers of a limited liability company can choose how the limited liability company will be taxed. Generally speaking an LLC with one member may be taxed either as a corporation or as a sole proprietorship. LLCs with two or more members may be taxed either as a partnership or as a corporation. Note that for one member LLCs, this decision will also impact whether the LLC needs a tax identification number. The Minnesota Department of Revenue has indicated that a Minnesota limited liability company will receive the tax treatment for state purposes that it receives for federal purposes. Persons considering forming a limited liability company are advised to consult with a tax professional regarding the state and federal tax treatment of such an entity. See also the sections of the Small Business Assistance Office publication, *A Guide To Starting A Business In Minnesota* entitled "Choosing the Form of Business Organization – Tax and Non-Tax Considerations – Introduction" and "Choosing the Form of Business Organization – Tax and Non-Tax Considerations – Tax Considerations in Choosing the Form of Organization".

TAX CREDITS AND INCENTIVES

State of Minnesota tax credits and incentives presently available are:

- Credit for research and development expenditures (Minn. Stat. § 290.068). This provides a credit of 10 percent of the first $2 million in incremental eligible research and development expenses above a base amount. For eligible expenses above $2 million the credit is 2.5 percent.
- For C corporations, the alternative minimum tax (AMT) carryover credit (Minn. Stat. § 290.0921, subd. 8) allows a credit against corporate income tax for qualified alternative minimum tax previously paid. The entire amount of the credit must be carried into the earliest taxable year into which the credit may be carried, and any unused portion of the credit must be carried into the following taxable year.
- For individuals, the alternative minimum credit (Minn. Stat. § 290.091, subd. 6) provides a credit against income tax equal to the adjusted net minimum tax reduced by the minimum tax credits allowable in a prior tax year. Special definitions apply to computation of tax involving part time Minnesota residents, income from private activity bond revenue, income from depletion.
- The Greater Minnesota Business Expansion Sales Tax Refund Program provides tax benefits to businesses located in Greater Minnesota that increase employment. Qualifying businesses that meet job-growth goals may receive sales tax refunds for purchases made during a seven-year period. Business must increase employment by a minimum of two FTE employees or 10 percent of the current number of employees at the facility, whichever is greater, within three years of being certified, and pay compensation to all the facility's employees of at least 120 percent of the federal poverty level for a family of four. The business must not be primarily engaged in retail sales or in several other specified industries. A maximum of $7 million per year may be refunded to all businesses participating in the program.
- The Minnesota Angel Investment Tax Credit is available to natural persons only for investments in four types of businesses: those using proprietary technology to add value to a process, product or service in a qualified high technology field; those researching or developing a proprietary process, product or service in a qualified high technology field; and those researching, developing, or producing a new proprietary technology for use in agriculture, tourism, forestry, mining, manufacturing, transportation and those researching or developing a proprietary product, process, or service for use in agriculture, tourism, forestry, mining, manufacturing or transportation.

  The credit is 25 percent of the invested amount up to a maximum credit of $125,000 ($250,000 for taxpayers married and filing jointly). The credit is refundable: if the investor's tax liability is less than the amount of the credit, the state will issue a refund check for the difference.

  In addition to the proprietary technology and industry requirements noted above, the qualifying business in which the investment is made must be headquartered in Minnesota, have fewer than 25 employees, have at least 51 percent of its total payroll and personnel based in the state, be in operation for no more than 10 years (20 years if a medical device or pharmaceutical business), and cannot have received previous equity investments exceeding $4 million.

  Investors cannot receive a credit if they invest in a company that is publicly traded, if the investor is an officer or principal in the business, if the investor holds 20 percent or more of the voting power of businesses securities (either individually or in combination with family member), or if the investment is liquidated within 180 days of their investment.

Beginning in 2015, $7.5 million of the credits per year are reserved for investments in women-owned, minority-owned, and businesses located outside the Twin Cities seven county metro area. Should these reserved credits not be allocated by September 30th, they become available for investments in all qualified businesses.

- The Border City Development Zone credit (Minn. Stat. § 469.1732) offers property and sales tax credits to encourage businesses to locate in the Minnesota cities of Breckenridge, Dilworth, East Grand Forks, Moorhead, and Ortonville rather than to locate in other states. The city provides the business with a tax credit certificate in a specific amount, and the business files a claim for a refund from the Minnesota Department of Revenue.

- Job Opportunity Building Zones (JOBZ) are specific areas of the state encompassing 29,000 acres in 325 subzone communities where, for a maximum of 12 years, a number of tax incentives are available. These include: exemption from the corporate franchise tax; exemption from sales tax on goods and services used in the zone if purchased during the duration of the zone; exemption from income tax on business income generated by a business in the zone based on property and payroll in the zone; exemption from income tax from rent on tangible or personal property used in the zone; exemption from capital gains on the sale of real or tangible personal property in the zone; exemption from capital gains on the sale of an ownership interest in a business located in the zone. There is also a jobs credit for employers in the zone who increase employment and pay an average wage in excess of $30,000. Additional information, including information on application and the terms of a Business Subsidy Agreement implementing the JOBZ incentives is available on the Minnesota Department of Employment and Economic Development website at http://mn.gov/deed/business/financing-business/tax-credits/jobz/. Specific community and JOBZ site information is available at http://mn.gov/deed/business/locating-minnesota/land-bldg/statewide/.

- Credit in an amount equal to thirty percent of the cost of transit passes provided by an employer, to its employees, for use in Minnesota (Minn. Stat. § 290.06, subd. 28).

- Greater Minnesota Internship Program Credit up to $2,000 per intern. The credit is administered by the Office of Higher Education.

Federal tax credits that may be of interest to businesses are:

- Work Opportunity Federal Tax Credit provides an incentive to hire individuals from targeted groups that have a particularly high unemployment rate or other special "qualified first year wages" paid to individuals who begin work before January 1, 2014. The Minnesota Department of Employment and Economic Development, (Work Opportunity Tax Credit (WOTC) Unit) certifies members of targeted groups. Reference: www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Expanded-Work-Opportunity-Tax-Credit-Available-for-Hiring-Qualified-Veterans.

- The federal Small Business Health Care Tax Credit offers a tax credit of up to 35 percent of annual premiums paid toward health insurance for employees (50 percent beginning in 2014). An employer may claim the credit if it has 25 or fewer full-time employees (or the equivalent in full-time-equivalent employees), pays those employees average annual wages not over $50,000, and has in place a qualified health care insurance arrangement. But the full amount of the credit is available only to the smallest employers with the lowest paid employees—10 or fewer full-time employees and average wages of those employees not more than $25,000. The credit phases out for businesses with between 10 and 25 employees and average wages of between $25,000 and $50,000. The credit does not apply to premium amounts that exceed the average cost of health insurance plans in the state as determined by the Internal Revenue Service.

NON-MINNESOTA BUSINESSES DOING BUSINESS IN MINNESOTA

Non-Minnesota businesses which do business in Minnesota or own property in Minnesota may be subject to taxation by Minnesota if they have sufficient "nexus" or connection with Minnesota to justify imposition of Minnesota tax laws. Activities that create nexus include but are not limited to:

- Having a place of business in Minnesota;
- Having employees or independent contractors conducting business in Minnesota;
- Owning or leasing real property, or tangible personal property, in Minnesota, and
- Obtaining or regularly soliciting business from within Minnesota. Obtaining or soliciting business within Minnesota includes activities like selling products or services to customers in Minnesota who receive the product or service in Minnesota; engaging in transactions with customers in Minnesota that involve intangible property and result in income; leasing tangible personal property in Minnesota, and; selling or leasing real property located in Minnesota. Methods of regularly soliciting business in Minnesota include direct mail and phone solicitation, and various forms of advertising, including via print publications and radio and television.

This issue can be complicated to resolve. Further information on the nexus standards and exceptions, and other requirements for non-Minnesota businesses may be obtained from the Department of Revenue.

TAXATION OF FIRMS DOING BUSINESS WITHIN AND OUTSIDE MINNESOTA

Phase in of Single Factor Apportionment Formula

Between tax years 2007 and 2014, Minnesota is moving from a three factor apportionment formula (sales, property, payroll) to a single sales factor for purposes of a business apportioning its income to Minnesota for income tax purposes. The new formula is:

Year	Sales % Factor	Property % Factor	Payroll % Factor
2014 and later	100	0	0

"Throwback Rule"

Minnesota does not use the throwback rule. In determining what to count as an in-state sale for the apportionment formula, most states (including Minnesota) use the destination of the sale to determine where sales are assigned. For example, if the destination of a sale is in Minnesota, the sale is included in the sales factor as an in-state sale; if the destination of the sale is in another state, the sale is not an in-state sale. When a throwback rule is used, sales made to destinations in another state are counted as in-state sales because the selling corporation lacks taxable nexus in the destination state.

BUSINESS ACTIVITIES REPORT

Every corporation that has property or personnel in Minnesota or receives income from Minnesota sources is required to file with the Department of Revenue, Form M-4R, Business Activities Report, unless the corporation files a timely corporate income tax return (either Form M4 or Form M8), has a certificate of authority to do business in Minnesota, or is otherwise exempt from this requirement. A corporation that is required to file a Business Activities Report and fails to do so does not have any cause of action upon which it may bring suit under Minnesota law and is prevented from using Minnesota courts for all contracts executed and all causes of action that arose before the accounting period for which the corporation failed to file the report. The Commissioner of Revenue may disclose to litigants whether a Business Activities Report has been filed by a party to a lawsuit.

Copies of Form M-4R may be obtained from the Minnesota Department of Revenue. Questions may be directed to the department.

ESTIMATED TAX

Individuals who are sole proprietors, partners, S corporation shareholders, and members of limited liability companies generally will be required to make federal and Minnesota estimated tax payments if their income tax and, for federal purposes, self-employment tax will exceed taxes paid through withholding and credits by $500 or more ($1,000 for federal individual income tax purposes). The tax is determined on income from all sources, not just on income from the business. Individuals may use Federal Form 1040ES, Estimated Taxes for Individuals, or may voluntarily elect to use the Electronic Federal Tax Payments System (EFTPS) to make Federal estimated tax payments. The IRS introduced a new service in 2014 called Direct Pay, which can be used to pay estimated taxes. For more information, see www.irs.gov/Payments/Direct-Pay. Minnesota Form M14, Individual Estimated Tax Payment Vouchers must accompany Minnesota estimated tax payments. Note that Federal Form 1040-ES contains a worksheet to use to compute estimated tax payments. Minnesota also allows for making estimated payments on the Department of Revenue website, using direct debit or by credit/debit card. See www.revenue.state.mn.us/individuals/individ_income/Pages/Estimated_Tax.aspx.

A C corporation whose estimated tax is expected to be $500 or more must make estimated tax payments. A C corporation is not required to pay estimated taxes for the first year it is subject to tax in Minnesota. Federal estimated tax payments are deposited with an authorized financial institution. Minnesota payments are filed with the Department of Revenue. Corporations use federal Form 1120-W and Minnesota Form M-18 to calculate and make estimated tax payments. Partnerships and S corporations must make Minnesota estimated tax payments if their minimum fee and S corporation taxes are expected to be $500 or more, or if they have any nonresident individuals whose tax is expected to be $500 or more and who are included on the entity's composite income tax. Withholding of tax for nonresident partners or shareholders is subject to estimated tax requirements. Payments are filed with the Minnesota Department of Revenue on Form M-71 for partnerships and Form M-72 for S corporations.

Forms, worksheets and instructions for completing the forms are available from the Internal Revenue Service and the Minnesota Department of Revenue at the addresses and telephone numbers provided in the Resource Directory section of the *Guide*.

INCOME TAX PENALTIES AND INTEREST

Both the Internal Revenue Service and the Department of Revenue may assess monetary penalties and interest for failure to pay a required tax, for a substantial underpayment of tax, for failure to file a return, for both failure to file and failure to pay, and for filing a fraudulent, false or frivolous return. The Internal Revenue Service also may impose a monetary penalty for underpayment of tax due to negligence or disregard of the tax rules, or for a substantial understatement of income. In addition, both the federal government and the state may impose criminal penalties for deliberately failing to file a return or deliberately filing a false return.

The interest rate on unpaid taxes is adjusted periodically by both the Internal Revenue Service and the state to reflect current market rates.